INCOME-TAX REFERENCE

Before Mr. M. C. Chagla, Chief Justice and Mr. Justice Tendolkar.

BACHA F. GUZDAR (APPLICANT) *v.* THE COMMISSIONER OF INCOME-TAX, BOMBAY CITY (RESPONDENT).*

1952
March 28

Indian Income-tax Act (XI of 1921), s. 4 (3) (viii), ss. 2 (1), 6, 10 and 12—Part of income of companies growing, manufacturing and selling tea exempt from tax as "agricultural income"—Whether part of income from dividends of these companies exempt from tax as agricultural income in shareholder's hands—Expressions "agricultural income" and "revenue derived from land": proper interpretation of.

The assessee was a shareholder in two companies which carried on business of growing, manufacturing and selling tea. Sixty per cent of the income of these companies was exempt from Income-tax as agricultural income under Rule 24 of the Indian Income-tax Rules. The assessee contended that sixty per cent of her income from dividends of these two companies was agricultural income in her hands and therefore exempt under s. 4 (3) (*viii*) of the Indian Income-tax Act, 1921.

Held, that the dividends may be derived from profits from land used for agricultural purposes but in order to entitle the assessee to claim exemption under s. 4 (3) (*viii*) of the Act, it must be shown that profits derived from agricultural land are the immediate and effective and not remote source of income for which exemption is sought. The immediate and effective source of dividends is the declaration of dividend by the companies which alone entitled the assessee to receive the income.

Held, therefore, that no part of the dividend income in the hands of the assessee was income derived from land used for agricultural purposes and therefore exempt from Income-tax under s. 4 (3) (*viii*) of the Act.

Phaltan Sugar Works, Ltd. v. *The Commissioner of Income-tax, Phaltan State, Phaltan,*[1] explained.

Premier Construction Co. Ltd. v. *The Commissioner of Income-tax, Bombay City,*[2] *The Commissioner of Income-tax, Bihar and Orissa* v. *Sir Kameshwar Singh,*[3] *Caltex (India), Ltd.* v. *The Commissioner of Income-tax, Bombay City,*[4] *F. H. Hamilton* v. *The Commissioner of Inland Revenue,*[5] *Whelan* v. *Henning,*[6] *The Governor-General in Council* v. *The Raleigh Investment Co. Ltd.,*[7] *The Commissioner of Inland Revenue* v. *Forrest,*[8] *The Commissioner of Income-tax, Bengal* v. *The Hungerford Investment Trust, Ltd.,*[9] *The Commissioner of Income-tax, Bihar and Orissa* v. *Raja Bahadur Kamakhaya Narayan Singh and others,*[10] *Commissioner of Inland Revenue* v. *Blott,*[11] and

---

* Income-tax Reference No. 39 of 1951.

(1) (1949) 17 I. T. R. 499.
(2) (1948) 16 I. T. R. 380.
(3) (1935) 3 I. T. R. 305.
(4) (1952) 54 Bom. L. R. 222.
(5) (1931) 16 R. T. C. 213.
(6) (1924) 10 T. C. 263.
(7) (1944) 12 I. T. R. 265.
(8) (1924) 8 T. C. 704.
(9) (1936) 4 I. T. R. 270.
(10) (1948) I. T. R. 325.
(11) (1921) 2 A. C. 171.

1952
BACHA F. GUZDAR
v.
COMMISSIONER OF INCOME-TAX BOMBAY
Chagla C. J.

Maharajkumar Gopal Saran Narain Singh v. *Commissioner of Income-tax, Bihar and Orissa*,[1] referred to.

The facts are fully set out in the judgment of the learned Chief Justice.

At the instance of the assessee the following question was referred to the High Court under s. 66 (*1*) of the Indian Income-tax Act 1921:—

"Whether 60 per cent of the dividends amounting to Rs. 2,750 received by the assessee from the two tea companies is agricultural income and as such exempt under s. 4 (*3*) (*viii*) of the Act?"

The reference was heard.

Sir J. B. Kanga with *R. J. Kolah*, for the applicant.

C. K. Daphtary, Solicitor General, for the respondent.

CHAGLA C. J. A very important question arises on this reference as to the liability of an assessee to pay tax on his dividend income when the dividend has been received from a company which derives its profits from agricultural activities and whose income or part of it is exempt from tax on the ground that it constitutes agricultural income.

The facts are very few. The assessee held shares in two tea companies, Patrakola Tea Co. Ltd., and the Bishnauth Tea Co., Ltd., and in the year of account she received dividends aggregating to Rs. 2,750 on the shares that she held. These two tea companies carry on the business of growing and manufacturing tea. 40 per cent. of the income of the tea companies was taxed as income from the manufacture and sale of tea, while 60 per cent. was exempt from tax as agricultural income. This was pursuant to r. 24 of the Indian Income-tax Rules. The contention of the assessee before the Tribunal was and it is before us that 60 per cent. of this dividend income was agricultural income in her hand and therefore was exempt from tax. A large number of authorities have been cited at the bar and our attention has been drawn to various observations made by different High Courts and the Privy Council. There is no direct decision on this point and therefore it is advisable first to look at the Act itself and to consider what are the principles which should govern this case before we turn to the authorities.

Now, exemption from tax can only be claimed under s. 4 (*3*) of the Income-tax Act and that section provides that any income, profits or gains falling within the following classes shall

[1] (1935) 3 I. T. R. 237.

not be included in the total income of the person receiving them. Therefore, it is for the assessee to satisfy us that the income received by her falls within any of the classes enumerated in s. 4 (3), and the contention of the assessee is that her income falls in the category of agricultural income mentioned in s. 4 (3) (*viii*). Therefore, it is only if her income is agricultural income that she is entitled to exemption from tax. "Agricultural income" is defined in the Act itself and the definition is "any rent or revenue derived from land which is used for agricultural purposes". Therefore, the assessee must satisfy us that the dividend which she has received from the two tea companies is a revenue derived from land which is used for agricultural purposes. It seems difficult to understand how it could possibly be urged by the assessee that the dividend which she has received as a shareholder from these two companies is revenue derived from land which is used for agricultural purposes. But Sir Jamshedji with his usual skilful advocacy has tried to persuade us that on the authorities and on the true position of a shareholder and on the rights that a shareholder has, the dividend income of the assessee is the same identical income which the company derives from agricultural processes.

Now, let us look at the position of a company and its shareholders under the general law and under the Income-tax Act. It is elementary and unnecessary to repeat that a company is a separate entity from its shareholders. Sir Jamshedji tried to draw an analogy between a partnership which does agricultural business and whose income is agricultural income, and a company whose income is agricultural income. In my opinion the analogy is entirely unsustainable. Law does not recognise a partnership as a separate entity and in law there is no such thing as partnership independently of partners. A partnership is merely a compendious expression to describe various persons who are carrying on business in partnership. It is true that when a partnership has agricultural income and the partnership is registered under the Indian Income-tax Act, in the assessment of individual partners the agricultural income would be exempted, because there is no distinction in law between the income of the partners and the income of the partnership. Entirely different is the position with regard to a company. It cannot be said that the income of the company is the income of the shareholders. Not only is a company and a shareholder separate and independent entities under the general law, but even under the Indian Income-tax Act a company is a separate

1952

BACHA F. GUZDAR v. COMMISSIONER OF INCOME-TAX BOMBAY

Chagla C. J.

entity for the purpose of assessment from a shareholder. A company pays income-tax on its income or its profits. It does not pay income-tax on behalf of the shareholders. A shareholder pays tax on his own income which may include income derived from dividends, and it is true as Sir Jamshedji has pointed out that the law provides that a shareholder is entitled to refund if tax has been paid by the company on the income which is represented by the dividends received by him. But this is merely as a legal fiction that it is recognised that the tax has been paid by the company on behalf of the shareholder and therefore the shareholder is entitled to a refund. In fact and in law income-tax is paid by the company as a company on its own income and the shareholder also in fact and in law has to pay tax on his own income. Take the case of super-tax. The company pays super-tax on its income. On the same income the shareholder when he receives a dividend as representing part of those profits or income also pays Super-tax and no rebate is given to the shareholder. Therefore, on the same income earned the company pays super-tax and the shareholder also pays super-tax. The reason is not that there is duplication of taxation, but because in the eye of the law and in the eye of the fiscal taxing statute the company and the shareholder are different separate independent entities, and the tax paid by the company is a different tax from the tax paid by the shareholder. It is also true, as pointed out by Sir Jamshedji that when a man buys shares of a company and invests his moneys in buying those shares, he becomes entitled to participate in the profits made by the company. But this expression "right to participate in the profits of a company" is rather an anomalous and confusing expression. What it really means is that a shareholder has a right to participate in the profits of the company only when profits are distributed and a dividend is declared. Till a dividend is declared the shareholder has no right to the profits earned by the company. The further important fact which has got to be borne in mind is that when profits are distributed and a dividend is declared, the shareholder becomes the creditor of the company and the company is liable to pay the dividend as a debt.

Now, when these general principles are borne in mind, can it be said that the assessee in this case, who has received dividends from these two companies in which she is a shareholder and which companies' income or part of it is agricultural income, has herself derived income from land which is used for

agricultural purposes. The income of the two companies would be, I take it, business income and it would be assessable under s. 10 of the Income-tax Act. The income of the assessee is dividend income assessable under s. 12. The income of the company would fall under one head as set out in s. 6. The income of the assessee would fall under an entirely diffrent head under s. 6. But the contention of Sir Jamshedji is that although the heads may be different the dividend which the assessee has received has been received from the same source as the income made by the company. Sir Jamshedji says that the dividend received by the assessee is nothing more than the very income which the companies derived and which was ultimately distributed between the shareholders who were entitled to the profits. This argument would have considerable force and validity if a shareholder had the same right to the profits of a company that a partner has to the profits made by the partnership. But as I have pointed out before, whereas a partner has a right independently of any condition being satisfied, a shareholder has no such right unless the most important condition is satisfied, viz. that the profits are distributed and a dividend is declared. To my mind the difference between the position of a partner and a shareholder in this respect is vital and that difference distinguishes the case of a partner from that of a shareholder.

Turning to the authorities, I am afraid I am myself largely responsible for the difficulty created by certain observations which I made when delivering the judgment of this Court in *Phaltan Sugar Works* v. *Commissioner I. T.*[1] Now, the observations of every Judge and of every Court must be read in the light of the facts actually decided and the point that arose for decision. What were the facts in *Phaltan Sugar Works'* case which called for the observations on which such strong reliance is placed and rightly placed by Sir Jamshedji? What we were dealing with in that case was a contention that inasmuch as the Phaltan Government had exempted by a contract the Phaltan Sugar Works from paying tax, therefore there was no obligation upon the company to deduct at source the tax from the dividends which it paid to its shareholders. Sir Jamshedji's contention was that the company itself was exempted from payment of tax and therefore the shareholders were also exempted from payment of tax. This argument was rejected by us and we held that a mere contract between a

[1] (1949) 51 Bom. L. R. 725.

1952

Bacha F. Guzdar v. Commissioner of Income-tax, Bombay

Chagla C. J.

Government and a company by which a company was not liable to pay tax did not make the income of that company unassessable, and it was in this connection that the following observations were made in the judgment which I delivered (p. 732):

"...Now, Sir Jamshedji says that the dividend which came to the hands of the shareholders was not liable to tax at all because the profits out of which dividends were paid were not liable to tax in the hands of the company, and Sir Jamshedji says that if an income bears a certain character, that character cannot be altered because it is transferred from the company to the shareholders. The principle which Sir Jamshedji enunciates is unexceptional, and I entirely agree with him that if the income bore a character which exempted it from payment of tax, then the mere fact that that income was transferred to the shareholders in the shape of dividends would not alter its nature or character and that income would still not be liable to tax. That principle has been recently enunciated or rather re-enunciated by the Privy Council in the case of *Premier Construction* Co. v. *Comr. I. T.*[1]"

Therefore, the particular case we are considering today did not arise before us for decision, and in making the observations which I did at p. 732 I was merely giving effect to or what I thought I was doing was giving effect to the principal enunciated by the Privy Council in the *Premier Construction*[1] case. It was no new principle which this Court was laying down, but this Court was merely paraphrazing what the Privy Council had observed in the *Premier Construction Co.'s*[1] case.

Therefore, it would be perhaps best to turn to the Privy Council case itself to find out what was decided in that case. That case is reported in *Premier Construction* Co. v. *Comr. I. T.*[1] That was a case where under a managing agency agreement the assessee was entitled to receive 10 per cent. of the profits made by the company and the income of the company was agricultural income, and the assessee claimed exemption from tax on the ground that his income was derived from agricultural income. That contention was rejected by the Privy Council and after reviewing the case Sir John Beaumont delivering the judgment of the Privy Council stated (p. 5):

"In their Lordships' view the principle to be derived from a consideration of the terms of the Income-tax Act and the authorities referred to is that where an assessee receives income, not itself of a character to fall within the definition of agricultural income contained in the Act, such income does not assume the character of agricultural income by reason of the source from which it is derived, or the method by which it is calculated."

[1] (1948) 51 Bom. L. R. 3, s. c. L. R. 75 I. A. 246.

1952

BACHA F. GUZDAR v. COMMISSIONER OF INCOME-TAX BOMBAY

Chagla C. J.

Pausing here for a moment, it is clear that what the Privy Council was considering was a case of a direct recipient of agricultural income and what the Privy Council was emphasing was that when you have a direct recipient of agricultural income it is irrelevant to consider in what character he receives the agricultural income, and the case they had in mind was the case to which they had referred earlier, viz. the case of *Commissioner of Income-tax, B. & O. v. Sir Kameshwar Singh.*[1] In that case a mortgagee went into possession and received rents from lands belonging to the mortgagor and it was contended that as the lands belonged to the mortgagor and as the income was being received by the mortgagee in his capacity as mortgagee, he was not entitled to exemption from tax. That argument was rejected by the Privy Council. Now, to go on with the passage which I was referring to (p. 5):

> "...But if the income received falls within the definition of agricultural income, it earns exemption, in whatever character the assessee receives it."

This again emphasises the same aspect. Then to go on (p. 5):

> "...In the present case the assessee received no agricultural income as defined by the Act; it received remuneration under a contract for personal service calculated on the amount of profits earned by the employer, payable, not in specie out of any item of such profits, but out of any moneys of the employer available for the purpose."

Therefore, the Privy Council having found that the managing agent did not receive any income derived from lands but received remuneration as a result of contractual relations between him and the company, the income did not constitute agricultural income. If this is the case we were relying upon in *Phaltan Sugar Works Co.'s* case, surely it cannot be said that the Privy Council laid down that when an income is earned by a company and that income is transferred by the company to the shareholder in the shape of a dividend (I am prepared to accept this contention of Sir Jamshedji) and that shareholder becomes entitled to that part of the profit only when the dividend is declared and it comes in the hands of the shareholder, the income received *maintains* the same character and continues to be an agricultural income. In my opinion it would be an unwarranted extension of the decision of the Privy Council to come to that conclusion.

Then reliance is placed upon another judgment of this Court which was recently delivered in *Caltex (India), Ltd. v.*

(1) (1935) 37 Bom. L. R 822, P. C. (2)

1952

BACHA F. GUZDAR
v.
COMMISSIONER OF INCOME-TAX BOMBAY

Chagla C. J.

Comr. of I. T.[1] What we were there considering was whether the Caltex (India) Ltd. could be appointed the statutory agent under s. 43 of the California Texas Oil Co., Ltd., which was incorporated in the Bahama Islands. California Texas Oil Co. was a shareholder of Caltex (India) Ltd. and as such shareholder received dividend from the Caltex (India) Ltd., and the question that fell to be considered was whether the California Texas Oil Co. was liable to pay tax in India under s. 42 of the Act. It was in this connection that the observations relied upon by Sir Jamshedji were made. We held there that income, profits or gains accrued to the California Company by reason of the fact that there was a source of income in British India and the source of income according to us was the profits made by the Indian company in India. Sir Jamshedji contended that dividends could not be said to have been derived from profits and we rejected that contention, and at page 229 of the judgment it is stated:

"If the source from which his dividend emanates is the profits made by the company, then undoubtedly the dividend that he receives is an income which arises from that source."

It cannot be disputed that in one sense, and perhaps an important sense, the dividend received by an assessee is derived from the profits made by the company. But what we are concerned with in the present case is not whether the dividends are derived from the profits made by the company, but whether the dividends themselves constitute revenue derived from land, and as I shall presently point out, even though the source may be the revenue derived from land within the meaning of the Act, it is not sufficient that that should be the source in a remote sense; it must be the source in the sense of its being an effective source. It must be shown that directly and effectively without any intervention the dividend represented revenue derived from land or that the effective source of the dividend was revenue derived from land. In my opinion it is impossible to predicate of a dividend that the effective source of the dividend is revenue derived from land or the agricultural income earned by the company. The effective source of this particular kind of income which is subject to tax is the declaration of dividend by the company. It is that and that alone which entitles the assessee to receive the income.

[1] (1951) 54 Bom. L. R. 222.

1952

BACHA F. GUZDAR v. COMMISSIONER OF INCOME-TAX BOMBAY

Chagla C. J.

Reliance has also been placed by Sir Jamshedji on another decision of the Privy Council in *Commissioner of Income-tax, B. and O.* v. *Sir Kameshwar Singh,*[1] and the observations relied upon are at p. 825:

"...The exemption (Lord Macmillan says in his judgment) is conferred, and conferred indelibly, on a particular kind of income and does not depend on the character of the recipient, contrasting thus with the exemption conferred by the same sub-section on the income of local authorities."

With respect the observation is perfectly sound, because if it is found that a person has received agricultural income and that he is the recipient of that income, then it is immaterial what character he bears, because what is important under the Income-tax Act is the character of the income and not the character of the recipient. Again, the facts in regard to which these observations were made are important. A money-lender had conveyed to him by his debtor certain properties and he received income from these lands, and the contention was that he had received this income in his character as a money-lender and therefore the income was not exempted from tax. It is in rejecting that contention that Lord Macmillan gave expression to this statement.

Very strong reliance has been placed by Sir Jamshedji on a decision of the English Court reported in *F. H. Hamilton* v. *Commissioners of Inland Revenue.*[2] In that case the assessee contended that he had received a dividend from a company exceeding the amount of the income of the company and that therefore he should be taxed only in respect of that part of the dividend which corresponded to the actual income of the company. This contention was rejected by Mr. Justice Rowlatt. In his judgment he referred to another case which he had decided and which was relied upon on behalf of the assessee and that was *Whelan* v. *Henning.*[3] In that case the assessee had received a sum of £ 35 as dividend. No tax had been paid by the company and yet the Income-tax Commissioners added to the sum of £ 35 the sum of £ 9 which according to them was the tax that should have been paid in respect of the dividend of £ 35 and wanted to assess the assessee to super-tax on £ 44. Mr. Justice Rowlatt in that case held that the Commissioners were not justified in assessing the assessee to a larger amount than £ 35, and it was in that connection that

(1) (1935) 37 Bom. L. R. 822, P. C. (2) (1931) 16 R. T. C. 213.
(3) (1924) 10 T. C. 263.

1952

BACHA F. GUZDAR v. COMMISSIONER OF INCOME-TAX BOMBAY

Chagla C. J.

the remarks were made by Mr. Justice Rowlatt on which reliance has been placed. This is what the learned Judge said (p. 221):

"It was said that the £ 35 was a taxable sum in itself, never mind what the company had done; that was the dividend and a profit and gain, and it ought to be taxed. As to that, I held (as I thought and think, rightly) that a dividend, is not a taxable subject matter in itself. The operation of declaring a dividend is not an operation which gives birth to a profit or gain; it is only the division of profits or gains earned by the trading operation, which is the only source of profit or gain, and the declaration of the dividend is merely the division, without any income accruing, of the profits and gains realised."

What was being emphasized by the learned Judge was that the company is assessed in respect of the trading operation, profits or gains are earned by reason of the trading operation and the tax is paid by the company in respect of the profits and gains, and if the company had paid no tax, when dividend was received by the assessee, the dividend itself could not be considered as something which would attract to it the tax in respect of the profits and gains which had themselves not been subjected to tax.

In connection with the nature of dividend, Sir Jamshedji has relied on a statement of the law in Buckley's Companies Acts, 12th edn., at page 894, and it is pointed out that

"Etymologically a dividend is the 'dividendum,' the total divisible sum. But in its ordinary sense it means the sum paid and received as the quotient forming the share of the divisible sum payable to the recipient;"

and it is further pointed out that (p. 894):

"Whether the whole or any part shall be divided or what portion shall be divided and what retained are ordinarily questions of internal management for the decision of the shareholders subject, if the articles so provide, to the recommendation of the directors, which the Court has no jurisdiction to control or review."

But as it is well known, all articles have now compulsorily to provide that profits shall not be distributed otherwise than as recommended by the directors. But what is overlooked by Sir Jamshedji is that a shareholder is not entitled to the profits of the company as such. He has no right to claim any share of the profits. His right only arises when a resolution is passed declaring a dividend.

Sir Jamshedji has also relied on a judgment of the Federal Court reported in *Governor-General in Council* v. *Raleigh Investment Co. Ltd.*[1] The Federal Court was considering the

[1] (1944) 6 F. C. R. 229.

same question that we considered in *Raleigh's* case and what was contended by the assessee in that case was that s. 4 (*1*) (*c*) and Explanation 3 of the Act were *ultra vires* in so far as they purported to authorise the levy of tax on non-resident companies in respect of income from dividends which had accrued to them outside British India, and the Federal Court held that the Indian Legislature in enacting that particular provision was not giving any extra-territorial operation to its law, and it was in this connection that observations were made by Chief Justice Spens at p. 250:

"It is true that the profits of a company may not materialise into a dividend for the shareholder till a dividend is declared, but that is different from saying that when the dividend is declared the 'source' of the dividend is not the same as the source of the profits made by the company."

But as I shall presently point out, what is necessary for us to decide is not that the ultimate source of the dividend is the same as the source of the profits made by the company. What we have to decide is whether land used for agricultural purposes is the effective and immediate source of the dividend received by the assessee. In the same connection Sir Jamshedji also relied on an observation of Lord Anderson in *Commissioners of Inland Revenue* v. *Forrest.*[1] Lord Anderson is describing what are the rights of a person who invests moneys in the shares of a company and this is what the learned Law Lord says (p. 710):

"He buys two things with his money. He buys, in the first place, a share of the assets of the industrial concern proportionate to the number of shares which he has purchased; and he also buys the right to participate in any profits which the company may make in the future."

With respect, the right to which Lord Anderson refers is not an unconditional right. It is not the right that a partner has in partnership profits. As I have said before, it is a right conditioned by a declaration of dividends being made by the company.

Reliance has also been placed on a decision of the Privy Council reported in *Commissioner of Income-tax, Bengal* v. *Hungerford Investment Trust, Limited.*[2] The Privy Council was considering s. 14 (2) (*a*) of the Indian Income-tax Act of 1922 which provided that an assessee who had received dividends as a shareholder was exempt from Income-tax in respect of that dividend where the profits and gains of the company

(1) (1924) 8 T. C. 704.

(2) (1936) 38 Bom. L. R. 1004, s. c. L. R. 63 I. A. 359.

1952
BACHA F. GUZDAR v. COMMISSIONER OF INCOME-TAX BOMBAY
Chagla C. J.

had been assessed to tax, and the Privy Council was pointing out the principle underlying that section, and Sir George Rankin delivering the judgment of the Board stated (p. 1008):

> "...The underlying principle of the clause, as the Commissioner in stating the present case has recognised, is 'that the dividend represents merely the shareholders' share in the income of the company.'"

But again, what is overlooked is that if there was no distinction between the dividend income of the shareholder and the income of the company, there would have been no necessity for the Legislature to enact s. 14 (*2*) (*a*). The very fact that this section was enacted clearly shows that but for that enactment the shareholder would have been liable to pay tax on the dividend although the company had already been assessed to tax. The provision in the present Act also emphasizes that principle. Therefore, the taxing statute has always made a distinction between the income of the company and the income of the shareholder. Those incomes are separate and distinct, and but for special provisions in the taxing statute, which may either exempt the shareholder from paying tax on the dividend when the company has already been subjected to tax or where the taxing statute might give a rebate to the assessee in respect of the amount paid as tax on the dividend by the company, the assessee would be liable to pay tax on the dividend.

But the most helpful and illuminating decision to which our attention has been drawn is the judgment of the Privy Council in *Comr. I. T., Bihar* v. *Kamakhya Narayan Singh.*[1] The contention that was urged before the Privy Council was that interest on arrears of rent payable in respect of land used for agricultural purposes was agricultural income within the definition of the Act and was therefore exempt from tax. This contention was rejected by the Privy Council and Lord Uthwatt delivering the judgment of the Board made the following observation (p. 183):

> "Equally clearly the interest on rent is revenue, but in their Lordships' opinion it is not revenue derived from land. It is no doubt true that without the obligation to pay rent—and rent is obviously derived from land—there could be no arrears of rent and without arrears of rent there would be no interest. But the affirmative proposition that interest is derived from land does not emerge from this series of facts. All that emerges is that as regards the interest, land rent and non-payment of rent stand together as *cause sine quilus non.* The source from which the interest is derived has not thereby been ascertained."

[1] (1948) 51 Bom. L. R. 182, s. c. L. R. 75 I. A. 283.

Now, applying this argument to the fact of this case, Sir Jamshedji has argued exactly what was considered by the Privy Council as not a sound argument. Sir Jamshedji's argument is that without income made by the company there would be no dividends and therefore dividends are derived from land and therefore dividends constitute agricultural income. Then Lord Uthwatt goes on to say (p. 183):

> "The word 'derived' is not a term of art. Its use in the definition indeed demands an enquiry into the genealogy of the product. But the enquiry should stop as soon as the effective source is discovered. In the genealogical tree of the interest land indeed appears in the second degree, but the immediate and effective source is rent, which has suffered the accident of non-payment. And rent is not land within the meaning of the definition."

If we were to draw a genealogical tree, with regard to the income of the assessee, then undoubtedly land would appear in that tree, but it would appear in the second degree. What would appear in the first degree would be the declaration of the dividend which entitled him to receive the dividend which constituted a debt due to him by the company and which cast an obligation upon the company to pay him the dividend. Therefore, in the language of Lord Uthwatt the immediate and effective source of the assessee's income is not land. Land is the immediate and effective source of profits earned by the company, but the immediate and effective source of the assessee's income is the declaration of dividends which entitles the assessee to receive the dividend.

Therefore, in my opinion, both on principle and on a review of authorities, it cannot be said that the income of the assessee which falls under the head "other sources" and which constitutes her dividend income, is an income which is derived from land which is used for agricultural purposes. I would therefore answer the question put to us in the negative.

TENDOLKAR J. I agree, but having regard to the importance of the question referred to us, I would like to add a few observations. The true answer to the question must depend upon a correct appreciation of the relation between a company and its shareholders and the proper interpretation to be placed upon the definition of "agricultural income" in s. 2 (*1*) of the Indian Income-tax Act. Now, there cannot be any question that a company in law is an entirely separate entity from the shareholders. A company is in no sense an agent of the shareholder or of the shareholders even collectively. It

1952

BACHA F. GUZDAR v. COMMISSIONER OF INCOME-TAX BOMBAY

Tendolkar J.

is perfectly true that a shareholder when he purchases a share acquires a right to share in the distribution of profits, which is a somewhat different thing from saying that he acquires a right to share in the profits, because the profits made by the company may never be shared by the shareholders at all if no dividends are in fact declared. The company when it earns profits does not earn them as an agent of the shareholders and the shareholders have no right in any profit earned until a dividend is in fact declared in the manner provided by the articles of association of a company. It is important in this connection to remember that although the articles of association may make what provision they like for the declaration of the dividend, s. 17 (2) of the Companies Act provides that there shall be deemed to be included in all articles of association certain regulations contained in Table A to the First Schedule of that Act, and one of such regulations is Regulation 95 which provides that the company in general meeting may declare a dividend, but no dividend shall exceed the amount recommended by the directors. The result of this of necessity is that if the directors choose to recommend no dividend, no dividend can be declared by the shareholders in general meeting, which could not be the position if the profits were made by the company as an agent of the shareholders and the shareholders were at liberty to divide them between themselves as they liked. Therefore, in law, between the shareholder and the profits are interposed the directors who can prevent the distribution of profits. Moreover, a dividend when declared becomes a debt and can be recovered from the company, not necessarily out of the profits made, but out of any assets belonging to the company. It seems to me, therefore, to be quite impossible to say that the profits of the company are the profits of the shareholders. Sir Jamshedji has contended that a company is after all a glorified edition of a firm. That contention, in my opinion, is wholly untenable. In the eye of the law persons who have entered into a partnership are individually called partners and collectively a firm, so that when one is dealing with a firm, everything done by the firm is for the benefit of the partners direct and a partner is in law an agent of the firm for all purposes each partner being an agent of the other partners also for the purpose of the business of the firm. That position does not obtain in the case of a company. A company is not the agent of a shareholder or shareholders, nor are the shareholders agents of the company for the purpose of the business of the company. There

is, therefore, in my opinion, no analogy whatsoever between the profits made by a firm and the profits made by a company. In the eye of the income tax law as well, the company and the shareholders are distinct entities, and where a company pays tax on its income, it pays it on its own behalf and not on behalf of the shareholders. That was laid down in felicitous language by Viscount Cave in *Inland Revenue Commissioners* v. *Blott*: *Inland Revenue Commissioners* v. *Greenwood*,[1] where the learned Law Lord observes (p. 201):

"...Plainly, a company paying income tax on its profits does not pay it as agent for its shareholders. It pays as a taxpayer, and if no dividend is declared the shareholders have no direct concern in the payment. If a dividend is declared, the company is entitled to deduct from such dividend a proportionate part of the amount of the tax previously paid by the company; and in that case the payment by the company operates in relief of the shareholder. But no agency, properly so called, is involved."

Therefore, under the income tax law as well, there is no agency between a company and its shareholders.

Turning next to the definition of "agricultural income" under which an income has to fall in order to secure an exemption from liability to tax, the material words of that definition are "derived from land.". Now of course, in its ordinary sense it would be very difficult to say that the income derived by the shareholder, who is the assessee in this case, was derived from land, in any event in the sense that it was directly derived from land. But what is urged by Sir Jamshedji is that the dividends were paid out of profits which included agricultural income, and to the extent to which they were so paid they are agricultural income in the hands of the shareholders. That contention, in my opinion, is unsound. It is of course obvious that dividends can only be paid out of the income, profits and gains of the company, and in that sense the income, profits and gains are the source of the dividend and have been held to be so in many of the authorities relied upon by Sir Jamshedji. But it does not follow from that that the dividend partakes of the nature of the income out of which it is paid. Thus, for example, a company may have, in addition to income from business, income from property, and the proportionate share in the dividend distributed which is attributable to income from property would not in the hands of the assessee, the shareholder, be income from property. Again, in

(1) [1921] 2 A. C. 171.

1952

BACHA F. GUZDAR v. COMMISSIONER OF INCOME-TAX BOMBAY

Tendolkar J.

the case of any income of the company by way of interest on securities or dividends on shares of other companies held by such company, although there would be a deduction of tax at the source, the company alone could seek the benefit of such deductions, and an individual shareholder could not claim that since there was included in the income of the company interest on securities or dividend on shares on which tax had been deducted at the source, in his own assessment as well he ought to get a proportionate credit for the tax so deducted. It seems to me, therefore, apparent that the dividend, although it comes out of the income of the company, does not necessarily partake of the character of that income in the hands of the shareholder. As I conceive it, the proper interpretation to be placed upon the words "derived from land" in s. 2 (*1*) is that in order to determine whether income is derived from land what one has got to look to is the immediate and effective source of income and not its remote or ultimate source. This view of the definition is, as I will presently point out, in consonance with all the four decisions of their Lordships of the Privy Council to which attention has been drawn.

The first of these decisions is in *Gopal Saran Narain Singh* v. *Commissioner of Income-tax, B. and O.*[1] In this case an assessee conveyed his share in a certain property to a co-sharer and in return the co-sharer agreed to repay the debts of the assessee and also to make an annual payment of Rs. 2,40,000 to the assessee for life. The question was whether the annual payment was agricultural income, and their Lordships held that it was not. There is no doubt that in this case the ultimate source of the income was the land, because but for the assessee having had the land which he conveyed to his co-sharer he would not have got the annual payment. But nonethe-less their Lordships held that this was not sufficient to make it agricultural income. Lord Russell of Killowen in his judgment observes (p. 820):

"In their Lordships' opinion it is impossible to hold that this annual payment is 'agricultural income' within the meaning of the Act. It is not rent or revenue derived from land; it is money payable under a contract imposing a personal liability on the covenantor, the discharge of which is secured by a charge on land. The covenantor is at liberty to make the payments out of any of her moneys, and is bound to make them whether the land is sufficiently productive or not."

[1] (1935) 37 Bom. L. R. 817, s. c. L. R. 62 I. A. 207.

1952

BACHA F. GUZDAR v. COMMISSIONER OF INCOME-TAX BOMBAY

Tendolkar J.

The next decision of their Lordships of the Privy Council is reported in the same volume at p. 822, *Commissioner of Income-tax B. and O.* v. *Sir Kameshwar Singh.*[1] In this case the assessee's father who carried on a money-lending business made a loan under an indenture described as 'a zarpeshgi lease with usufructuary mortgage.' A certain portion of the rent was reserved to the mortgagor as *thika* rent and the mortgagee was allowed to take the balance of the profits after deducting the expenses as *thika* profits in consideration of the loan. It was held that *thika* profits received by the assessee as mortgagee-lessee were exempt from income-tax, being agricultural income. The emphasis laid by their Lordships in this case was on the fact that the income was received by the assessee from land although it may be by virtue of the money-lending transactions and the case fell directly within the definition of "agricultural income". Lord Macmillan in his judgment observed (p. 825):

"Their Lordships find themselves in agreement with the learned Judges of the High Court in rejecting the appellant's contention. Section 4 (*1*) in declaring that 'this Act shall apply to all income, profits or gains as described or compromised in s. 6' is prefaced with the words "save as hereinafter provided," and thereinafter in the third sub-section it is expressly provided that 'this Act shall not apply to......agricultural income.' Similarly, s. 6, which includes 'business' among the 'heads of income, profits and gains...chargeable to income-tax,' opens with the words 'save as otherwise provided by this Act.' The result, in their Lordships' opinion, is to exclude 'agricultural income' altogether from the scope of the Act, howsoever or by whomsoever it may be received. As Ashworth, J., puts it in *In the matter of Mukund Sarup.*[2]—'The business of money lending may bring in an income which is exempt from income-tax on the ground that it is derived from agricultural land.' The exemption is conferred, and conferred indelibly, on a particular kind of income and does not depend on the character of the recipient, contrasting thus with the exemption conferred by the same sub-section on the 'income of local authorities.'"

Now, this passage in the judgment of Lord Macmillan is relied upon by Sir Jamshedji in support of the proposition that the character of agricultural income attaches to the income itself, and whosoever receives it, it is in his hands "agricultural income". But in my opinion that is not a correct reading of this passage in the judgment of His Lordship. The passage is in connection with an actual receipt by the assessee and therefore His Lordship observes that it does not matter in what character he received it so long as it is agricultural

[1] (1935) 37 Bom. L. R. 822, P. C. [2] (1927) 50 All. 495, 503, F. B.

1952

Bacha F. Guzdar
v.
Commissioner of Income-tax Bombay

Tendolkar J.

income. This decision was given at a time when the opening words of s. 4 (*3*) were different from what they are today. The words then were: "This Act shall not apply to the following classes of income," so that agricultural income was wholly excluded from the operation of the Act. These words were substituted in 1939 by the words which at present exist and which are: "Any income, profits or gains falling within the following classes shall not be included in the total income of the person receiving it," the emphasis in the amendment being on the receipt of income by the assessee, while under the old Act "agricultural income" by itself was exempted from the operation of the Act. This really emphasises what was even laid down by their Lordships under the old Act that receipt by the assessee is the main test and in the hands of the assessee the income must be received as agricultural income.

We next have two decisions of their Lordships of the Privy Council in 16 I. T. R. and 51 Bom. L. R. The first of these decisions is the decision of *Comr. I. T., Bihar* v. *Kamakhya Narayan Singh.*[1] In this case certain rent was payable in respect of land used for agricultural purposes. Rent was in arrears and interest on such arrears was payable. The question for decision was whether such interest was agricultural income. It was held by their Lordships that it was not. Lord Uthwatt, who delivered the opinion of their Lordships, observed (p. 183):

"The interest clearly is not rent. Rent is a technical conception, its leading characteristic being that it is a payment in money or in kind by one person to another in respect of the grant of a right to use land. Interest payable by statute on rent in arrear is not such a payment. It is not part of the rent, nor is it an accretion to it, though it is received in respect of it."

The learned Law Lord proceeded to observe (p. 183):

"The word 'derived' is not a term of art. Its use in the definition indeed demands an enquiry into the genealogy of the product. But the enquiry should stop as soon as the effective source is discovered. In the genealogical tree of the interest land indeed appears in the second degree, but the immediate and effective source is rent, which has suffered the accident of non-payment. And rent is not land within the meaning of the definition."

This decision in terms emphasizes that in order to give a meaning to the word "derived", although you may look back into the source of the income, you must not go right back to its ultimate source. The moment you come to an immediate

[1] (1948) 51 Bom. L. R. 182, s. c. L. R. 75 I. A. 283.

and effective source, one ought not to go any farther. The other decision of their Lordships of the Privy Council is reported in the same volume, *Premier Construction Co.* v. *Comr. I. T.*[1] This was a case of a managing agent who was to be remunerated at 10 per cent. on the annual profits of the company. A part of the income of the company was agricultural income and the question was whether this income was exempt from taxation as agricultural income. Their Lordships held that it was not. Sir John Beaumont, who delivered the opinion of their Lordships, observed (p. 5):

"In their Lordships' view the principle to be derived from a consideration of the terms of the Income-tax Act and the authorities referred to is that where an assessee receives income, not itself of a character to fall within the definition of agricultural income contained in the Act, such income does not assume the character of agricultural income by reason of the source from which it is derived, or the method by which it is calculated. But if the income received falls within the definition of agricultural income it earns exemption, in whatever character the assessee receives it."

These observations of their Lordships, in my opinion, emphasize two points. The first is that there must be a receipt of agricultural income by the assessee, and the second is that if what is received by the assessee is not agricultural income, then you cannot go back to its source and from that say that the income was agricultural income.

Certain observations which we made in a decision of this Division Bench in *Phaltan Sugar Works Ltd.* v. *Commissioner of Income-tax*[2] have been strongly relied upon by Sir Jamshedji. I was a party to that decision and I share my full responsibility for everything that was stated therein. The passage that was relied upon was a passage in the judgment delivered by my Lord the Chief Justice (p. 732):

"The principle which Sir Jamshedji enunciates is unexceptional, and I entirely agree with him that if the income bore a character which exempted it from payment of tax, then the mere fact that that income was transferred to the shareholders in the shape of dividends would not alter its nature or character and that income would still not be liable to tax. That principle has been recently enunciated or rather re-enunciated by the Privy Council in the case of *Premier Construction Co.* v. *Commr. I. T.*"

What we were there attempting to state was undoubtedly the effect of the Privy Council decision as we then conceived it to be. In the first instance, it is quite obvious when one looks

[1] (1948) 51 Bom. L. R. 3, s. c. L. R. 75 I. A. 246.

[2] (1949) 51 Bom. L. R. 725.

1952

BACHA F. GUZDAR v. COMMISSIONER OF INCOME-TAX BOMBAY

Tendolkar J.

at the facts of that case that this particular statement was not necessary for the decision of that reference, and to that extent the observations are obiter. But as My Lord the Chief Justice has pointed out in his judgment, every passage in a judgment must of necessity be read in the context of the facts of that particular case, and in any event as we made no attempt in that case to enunciate a new principle but merely attempted to state what we thought was the correct effect of the decision of the Privy Council in *Premier Construction Co. Ltd.* v. *Commissioner of Income Tax,* I must say that upon further reflection and upon a very careful consideration of the decision of their Lordships of the Privy Council in the Premier Construction Co.'s case, the ratio we attempted to lay down in that passage is not correctly stated.

In my opinion, therefore, the true interpretation of "agricultural income" must be income which is derived from land in the sense that the immediate and effective source of that income is land. In the case of a dividend, whatever may be the immediate source, it seems to me extremely difficult to say that the immediate source of that income is land. Until a dividend is declared, there is nothing that the share holder can get. The dividend is conditional upon a declaration being made in that behalf by the general body, and although the dividend ultimately may come out of profits—and indeed a dividend cannot be declared without profits being made—the immediate and effective source of that dividend cannot be taken to be land which is the remote or ultimate source of that income, and not the immediate and effective source.

I agree, therefore, respectfully, with My Lord the Chief Justice that the question referred to us should be answered in the negative.

Per curiam.

This is a reference more in the nature of a test case as thousands of shareholders holding shares in tea, rubber and other similar companies would be affected by the decision of this Court one way or the other. We therefore think that the fair order to make as to costs is that there will be no order as to costs.

Attorneys for applicant: *Payne & Co.*
Attorneys for Commissioner: *N. K. Petigara.*

Answer accordingly.

P. M. P.